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The Hungarian economic criminal law and the broker scandals in 2015

In our study, we give a sketch of the establishment and development of Hungarian economic criminal law, and its characteristic features after the change of regime. When examining this topic, we have to briefly treat the concept of economic criminal law and introduce the characteristic features of the Hungarian mode of regulating. Following this, we briefly look back at the period between the creation of the first Hungarian codified criminal code and the last decade of the past century. In the next chapter of the study, we analyse the criminal law aspects, controversies and lessons of moving to market economy, and finally, we touch upon a couple of current issues with view to the fact that our country has been a member of the European Union for two years, thus the norms of the union have also become a part of our legal system.

1. The concept of economic criminal law

Economic criminal law is the sum total of legal regulations within and outside criminal law that define which of the actions threatening the economic order (that is, the orderly operation of the economy) are considered criminal acts, how the perpetrators of these are to be held responsible, what sanctions can be applied against them and how.

We can make the following conclusions on the basis of the above definition:

- economic criminal law is a sub-area of criminal law; therefore, in a wider sense, it includes the procedural law regulations and the regulations of the execution of sentences which do not show marked differences from the general rules; therefore, we do not cover these;
- in Hungary, economic criminal law is constituted by criminal law (primary) norms and legal norms outside criminal law (secondary). The Hungarian criminal law is a unified, codified criminal law; we do not acknowledge the law-development role of judge-made law or only in a very narrow circle¹. The secondary (non-criminal law) norms play a role mostly when the primary norms do not contain all the positive and negative conditions of culpability. In this case, the criminal law norm sets out only that frame which the secondary norm fills with concrete contents. This is necessary because the frequent modification of the criminal code is undesirable; criminal law has to show a relative stability. Secondary norms, on the contrary, can be modified dynamically.²

¹ In our view, the role of judge-made law is not more than the explanation of the law, or the clarification of certain concepts, but analogy is forbidden: that is, the principle of “*nullum crimen sine lege*” is enforced.

² One example: In Hungary, the failure of the reporting obligation related to money laundering is a criminal act. But how wide a circle this obligation is enforced in and exactly what its contents are is defined by a secondary norm, this norm is Law XV of the year 2003, on the prevention and obstruction of money laundering. If, therefore, we would like to include several service providers in the circle of those with a reporting obligation, we do not necessarily have to reach for the criminal code, it is enough to modify or replace the secondary norm. We could continue the list with a number of secondary norms such as, for instance, the Law on Accountancy, the Bankruptcy Law or the Competition Law.

2. From Code Csemegi to the change of regime

We are only going to present a rough outline of the history of Hungarian economic criminal law, only from 1878, the birth of the first written criminal code. This law – which grateful posterity named after its creator, Csemegi Károly – already contained some economic criminal acts (for instance, counterfeiting and criminal bankruptcy). Sketchily, we can divide the period between 1878 and the present day into three main sections, according to the dominant economic system philosophy: “early” or liberal capitalism – socialism – “modern” capitalism. Naturally, within the three main sections, we can distinguish between further periods; and the exact setting out of the borderlines can also be debated (as the criminal law legal regulations react to economic and social changes only after a more-or-less long period of time).

Due to economic policy closely connected with the Austro-Hungarian Monarchy, preferring agriculture to industry, the liberal-capitalist development in Hungary could blossom only with some delay, and by the time the legal background could have fully developed, the First World War broke out. In the interest of the mitigation of the severe economic consequences, having tight control over production for the needs of the war and regulation, at this time, the continuity of provision was attempted to be kept up by means of extraordinary, mostly restrictive regulations.

In the decades following the war, the more “consolidated” forms of the intervention of the state by means of criminal law tools appeared one after the other: for instance, a law was created about price-hiking abuse, unfair competition, or loan fraud.

Naturally, during the course of the Second World War, such restricting measures that kept the interests of the military economy in mind were again needed.

In 1949, by accepting the Stalinist constitution, Hungary stepped on the “road of building socialism”. By relying on the principles of Marxist-Leninist economics, the communist party, in exclusive possession of political power (the Hungarian Workers’ Party), introduced a strictly controlled economy system. In addition to the strong centralisation of the economy, further characteristic features of this system involved control affecting the whole of the economy, as well as the consistent supervision of the economic processes, going into details.³ Social ownership became dominant in the economy (which meant the totality of state and cooperative ownership), and the proportion of private ownership fell to an insignificant proportion.

During the period of the introduction of planned economy, the principle of imperative planning was enforced, and the behaviour of the players of the economy was exactly prescribed. Central directions were applied in all the sectors of the economy. All this was accompanied by very strict economic law regulation. In place of the prescriptions of Code Csemegi affecting economic criminal law, regulations keeping in mind the unlimited, formal protection of the interests of the national economy plans were introduced. However, the possessors of political-economic power soon realised that the approach rigidly insisting on the prescriptions of the plans resulted not in the development of the economy but its falling back and regression. This new approach looked for the increase of social and personal well-being not in the rigid performance of the plan but a flexible control of the economy, taking the operation of economic laws into account. Thus, the second Hungarian Criminal Code created in 1961 (Law V of the year 1961) – according to the changed attitude – kept the content-protection of the plan in mind; that is, it only sanctioned those violations of obligation that are

³ Prof. Dr. Erdősy Emil: Gazdasági rendszerünk büntetőjogi védelme a tervgazdálkodás időszakában (In: Tóth Mihály-Gál István László (Editors): Gazdasági büntetőjogi tanulmányok Pécs, 2005. pp. 25-26)

formally against the law and that result in material consequences – that is, significant economic disadvantage – in the economic life.

As a result of the 1968 economic reform, independent economic accounting was introduced. This meant that within the framework of planned state control, companies have operative independence: they can sell their products as goods in the market, from their income they can cover their costs, and, in addition, they can achieve corporate net income. (They organise their activities as a legally independent economic unit.) Naturally, the economic reforms affected economic criminal law as well. Law-decree 28 of the year 1971⁴ secured the protection of the plan already within the framework of the restricted market conditions.

Our third, still valid Criminal Code was passed by the Parliament in 1978. Among the gradually increasing market conditions, Law IV of the year 1978 secured the criminal law protection of the planned economy until the change of regime taking place in 1989.

While the political collapse of the socialist system – to a great extent following the changes taking place in the Soviet Union – took place quickly and mostly unexpectedly, the severe economic crisis had been noticeable for a longer period of time. Standard of living had been continuously dropping in the second part of the 1980s, inflation accelerated, the indebtedness of the country got almost completely out of hand. In order to avoid complete anarchy, something had to be done to the economy by which a certain scope was offered by the fact that the economic policy of our country – as compared to the other countries of the eastern block – was somewhat more independent, liberal and open.⁵ Thus the commencement of the establishment of the market economy started before the first free elections (1990), and the company law aimed at the reorganisation of the state companies was accepted already in 1988. Following the political change of regime, the reorganisation of economic law accelerated. New laws were created one after the other (e.g. about the order of taxation and the individual taxes, the bankruptcy and liquidation procedures, accountancy, unfair market behaviour and the ban on competition restriction, financial institutions, or the stock exchange). According to this, the chapter of the Criminal Code regulating the economic criminal acts was changing continuously.

The last criminal acts supported by the earlier approach are also gradually being eliminated from this chapter (e.g. profiteering or offences against foreign currency regulations protecting the state monopoly of the trade of goods, foreign currencies and precious metals); however, according to the foreign recommendations, for instance, money laundering, computer fraud or insider trading are to be prosecuted.

However, the relatively flexible legal regulation could not prevent the appearance and spread of mostly new types of criminal acts that were fed primarily by the lessening of the role the state played, the mystification of the unlimited freedom of enterprise, the increase of revenue-distribution tensions⁶, or the strengthening of insecurities in the area of criminal prosecution that came with the transition.

⁴ In the socialist era, this legal source was at the same level as laws. It was issued not by the Parliament but by the Presidential Council of the Hungarian People's Republic. It was also possible to modify laws with law-decrees.

⁵ It is characteristic that the “business work communities” and the “subsidiary production branches” in the industry and the territory of services operated practically on the basis of completely individual interests, and in addition to the common land of the agricultural cooperatives, the members also had separate pieces of land, so-called household farms, serving individual production and marketing.

⁶ The Lorenz-curve, developed for the measurement of the concentration of income, started to curve to the right and down, which referred to a very unfavourable tendency. (In illustration of this process, here is a quotation from the Bible: “Those who have a lot receive even more, and those who have little have it taken away.”)

3. The characteristic economic criminal acts of the move to market economy

We can characterise the economic crime of the last decade and half in Hungary with three related types of crime: the so-called “oil-cases”, privatisation encroachment, and the fraudulent evasion of different dotations, allowances, contributions (reclamations).

a) If we asked people at random in Hungary today what economic crimes were the most characteristic in the years of the change of the regime, the answer would most probably be criminal acts in connection with oil and oil products. Smuggling related to this, excise encroachment, and tax fraud, have almost become signs of the 1990s.

In the beginning, the opportunity for encroachment was provided by the fact that there was a significant difference between the price of gasoline, used as motor fuel, and home heating oil – with a completely identical composition and quality – for socio-political reasons. This offered the chance for pocketing the profit from the price difference on a silver tray. Therefore, heating oil purchased at a lower price was used and sold as fuel. With the introduction of the new tax system, the difference grew even more as, in addition to higher VAT, fuel was also burdened by consumption tax, environmental product fee and road fund contribution. Therefore, the formal difference between the oil destined for two different purposes had to be made more marked and visible. Therefore, the colouring of heating oil was directed.

Essentially, it was the removal of the colouring agent by use of acids, the later infamous “oil bleaching”, which became an almost independent “criminal industry” in Hungary.

Thus the primitive method of distinguishing by means of dying did not work either, so in 1993, gasoline was made a (strictly controlled) excise product, while heating oil was sold by means of tickets.

There came – expectedly – the buying up of the tickets and the spread of ticket counterfeiting, the only answer to which could be the total abolition of the price difference. Thus this was the end of social sensitivity in 1995, but the only hope was that finally this also put an end to the oil mafia.

Unfortunately, this was unfounded, as, at the same time the decision was made, the tax-free status of the production and marketing of certain “light” oil products was also expanded. Needless to say, this is what happened: every day, dozens of trains were customs cleared that – according to the importers – carried sewing machine oil, anti-rust and anti-congealing agent. The quantity would have been enough for the whole world’s sewing machine fleet for several years. The issue stretched beyond the customs authorities and the police, and was already harping on the possibility of political interpenetration.

Today, oil fraud is practically not profitable any more, the allowances ceased to exist, or, as a result of the establishment of the sufficient control mechanism, they operate more or less properly.

By the time this took place, just the uncovered oil cases caused damage of about 90 billion HUF for the budget⁷.

b) The other marked projection of encroachment could be experienced in connection with the privatisation of state property.

⁷ The damage caused through economic crimes is 60-70 billion HUF per year recently (1 billion HUF = approximately 400,000 Euros), and only some 15% of this amount is covered in the criminal procedures. If we also take into consideration the criminal acts against property, damage of altogether 180-200 billion HUF caused through crime is lost without trace, and unfortunately there is no data about the subsequent recovery of at least a part of this amount.

The privatisation of companies and state cooperatives was often accompanied by the suspicion of corruption; however, only a fraction of such cases got to the court. It is a fact that different interest groups and associations also related to politics often got hold of valuable production and servicing plants which were not necessarily declining, with rather low starting capital and at a strikingly low price. In other cases, privatisation-related loans offered a possibility for establishing corrupt relationships.

The managing director of one of the banks, for instance, would provide credit for starting entrepreneurs on condition that the new owners gave 10-15% of the shares of the companies privatised from the loan to companies in the circle of interest of the managing director for free. After the case came to light, the banker said in his defense that he only used a bank practise frequently applied in developed countries: the institution of “the fiduciary hand”. According to this, the condition of providing a loan is that the debtor concludes a contract with the business counselling companies designated by the bank, and those, by following the profitability of the business of the company, ensure the return of the loan. However, according to the court, the general manager practically worked to fill his “own pocket”, and the debtors could not expect any counselling in return for the shares they handed over.

c) The third group of cases was constituted by the fraudulent use of the different allowances, dotations, exemptions and other financial possibilities provided by the state.

The method of commission is very simple here: the perpetrators fraudulently declare and – if need be – support with forged certificates that they are entitled to the given allowance.

When created, the law on investment secured customs and tax-free status to that person living abroad who – for the joint venture established by him – imported production tools to Hungary as contribution in kind. The motivation for the direction was clear: this is how the introduction of developed technology was endeavoured to be encouraged. A re-settled defendant of Hungarian origins, by establishing dozens of joint ventures that were not performing any actual business activities imported and then sold hundreds of cars as “contribution in kind”. His reasoning was based on the fact that the objects of the service also constituted production tools – and he did not conclude deeds of sale but leasing contracts (that is, performed services) – and it is nobody’s business that – within the scope of contractual freedom – the lessee paid 99% of the full leasing fee in one amount and paid the 1% in 12 monthly instalments. The charge raised because of smuggling was based on the fact that the transactions do not constitute service but deeds of sale (maybe attempted to be veiled in a primitive fashion), and production tools cannot be the objects of commercial trade; therefore, the defendant hid the actual purpose of the imported objects from the customs authority.

Naturally, fraud happened not only in connection with allowances for foreign investors; often, some tried to obtain support with socio-political purposes in a fraudulent way.

It happened that for years a group came into very high amounts of state support by stating that they provided work for close to one hundred employees with reduced work ability. In fact, they only employed two such persons but the doctor plotting with them issued false doctor’s certificates about the other workers.

In another case, people tried to make use of the fact that those families with several children who tried to solve their problem of establishing a home could expect significant amounts of non-reimbursable socio-political support for the purchase of the un-built-in attics of family homes.

The method of encroachment was that resourceful mediators brought together the claimants with several children with the owners of family houses with empty attics, from whom they purchased the attic on paper, had plans drawn up about making it liveable, with respect to which they requested support; and when they received that, with a new deed of sale, they simply transferred the attic – now as sellers – to the owners. Naturally, nobody moved anywhere, only paperwork took place. The amount of the support was then split up by the owner, the seller-buyer, and the owner of the idea, the mediator.

In this circle, the most serious and still existing problem is posed by the fraudulent reclamation of value-added tax.

The perpetrators of one of the most frequent economic criminal acts make use of the fact that the tax office reimburses entrepreneurs for the value-added tax of the goods they purchase (this is still very high in Hungary, 25%). There were masses of criminal procedures against people who did not perform any business activity but purchased fake invoices from criminal groups specialising in this, the so-called “invoice factories”, reclaimed the tax from the amount of the invoice, and paid commission from this to those forging the invoices. Unfortunately, this series of encroachment is practically still going on as of today, the only difference being that nowadays the fictitious reclamation is usually attempted to be covered up partly by actual economic activities.

The reaction of the state was also characteristic in these cases: after the criminal acts were discovered – but only after that – the system of the payment or control of the support was changed. However, resourceful perpetrators who are always a step ahead of criminal prosecution did not find it difficult to devise new possibilities.

4. Some lessons

It might not be without interest to take into account what more significant lessons we can state from the experience served by the above, typical criminal acts.

Our starting point is the previously proven fact that a major proportion of economic criminal acts (or criminal acts of an economic nature) is related to some allowance, support or exemption, as we have experienced not only in the latter group of cases but in connection with the “oil cases” as well.

Unfortunately, it is the characteristic feature of transitional market economies that these allowances are often used not according to their lawful purpose and normal market functions. The institution of leasing, for instance, is operated primarily not as the method of modern fixed assets development, but as veiled purchase if this is slightly better either for the seller or the buyer or both as, let’s say, the purchase of the object of lease does not constitute investment; however, the purchase price called lease fee can *always* be accounted in tax. Similarly, the foreigner’s contribution in kind does not serve the development of the enterprise or the introduction of modern technology, supported heating oil does not serve heating, and the cars imported under the name of the handicapped does not serve the transport of the handicapped (it is not he who will park with the parking permit issued to him for free). We have also seen that the good advice of the “counselling companies” operating within the framework of the “fiduciary hand” – unlike the developed western practice referred to – is usually not more than where and in what amount their kickback, called honorarium, is to be transferred.

Good examples of the almost regular *dysfunctional operation* are offered by the new forms of business management. Nowadays, we can still consider it typical that many establish business enterprises not necessarily because they want to establish the ideal structural framework of optimal business that is useful at an individual, corporate and social level, but so that they have a way to completely smuggle the income from the activity, and restrict the liability for the debts to the vanished company assets. Thus the *responsibility of the limited liability company* often becomes *unlimited individual absence of liability*.

Therefore we have to prepare for these encroachments originating still mostly from our transitional conditions and unfortunately must make preparations against them for the long run.

To avoid possible misunderstanding, we are not encouraging that the dotations be eliminated (from an economic point of view this would be an impossible requirement), but that they are

to be applied in a more conscious, considered, and controlled manner. We think that a more wary, careful but mostly more foreseeing regulation is needed.

We could also say: more and more pessimistic empathy.

Every decision that can put anybody – even indirectly – in a beneficiary position is to be made in such a way that we consider well in advance its consequences and forms “beyond the intent”, or, even better, its dysfunctional consequences and forms avoiding good intentions, and try to eliminate these in advance. All this requires primarily conscientious and circumspect lawmaking.

In addition to professional codification, we also think that it is a significant requirement that through the continuous training of policemen, prosecutors and judges, and the extension of their professional knowledge – which includes not just law and not only criminal law – a staff could be established and strengthened that – instead of the “following” and “reacting” approach, is able to give instant answers and to prevent. This also requires suitable organisational frameworks and – with economic crime becoming international – international relationships to be developed continuously, as well.

Finally, it is an important lesson that we must believe in the possibility of strengthening and developing economic morals.

During one of the visits he made home, Denis Szabo, professor of criminology of Hungarian origin, said that he could envisage the only way of forcing back crime: the re-establishment of human honesty. These are deeply true, respectable and pathetic words, even if we feel, for the time being, they do not fall into arable soil with us.

In the last decades, the role of economic morals more-or-less traditionally acknowledged and accepted in Western Europe was unknown in Hungary. The lack of moral rules of the economy and the unwritten norms of business ethics is a still stressful burden on our economy liberated from exterior and interior guardianship. The emerging market economy has little moral background, thus the legal regulation of the economy does not have moral coverage either. Among normal circumstances, *ethics* usually fills some mediating, assisting, orienting or even selecting role between everyday practise and the legal norms. In real market economies with great traditions, the basic moral rules of business activities are formed relatively early. In the rarest of cases these are written rules; it is not necessary to put them in writing as they are obvious, they form an organic part of the continuous operation of the economy. They function not as some ethics but as the basic conditions of belonging to the market and the operation of contractual relationships. It is natural that the obligations undertaken are to be abided by; the principle of “*pacta sunt servanda*” is not only a flowery catch-word but daily practise. It is also obvious – and it cannot be otherwise – that grabbers violating business honesty will be expelled; using unsecured loans, gambling, misleading and fraudulent manoeuvres conducted in the interest of economic advantages, misleading advertisements, the unlawful copying of the competitor’s trademark, marketing “Brummagem ware” or spoilt goods as excellent products necessarily leads to fall and final expulsion.⁸ *Basic business honesty*, therefore, even without fixed expectations is an indispensable element of market economy. This is how the business of countries we consider models can operate on the basis of the “honesty of the given word”, this is how contracts worth millions can be concluded by telephone, fax or even the Internet.

In our country, the paternalistic system of planned economy, interfering with everything, endeavouring to regulate everything, was not favourable for the emergence of unwritten regulations even indirectly. On the contrary: the omnipotence and respect of written rules was

⁸ Today, the actions listed are culpable without exception in the Hungarian Criminal Code. However, with firm ethical circumstances, a part of them would burden the law superfluously. The perpetrator of the crime entitled “marketing products of poor quality”, for instance, would be disqualified by the definite moral evaluation of the market once and for all from among the players of economic life.

getting stronger and stronger. Internal directions, circulars, lists of spheres of authority, working orders, and job descriptions multiplied and were often raised above the official sources of law. Though with the change of regime, the flow of this dropped significantly, the earlier approach hardly changed. On the wrecks of the pile of regulations and in lieu of the germs of business ethics, the interpretation of the principle of “anything that is not forbidden by legal regulations (naturally, written norms!) is allowed” became endless.

We would like to believe that business morals can be strengthened together with the development of the economy, but we are convinced they can be taught and learnt as well.

At the same time, the approach, motivation and even certain institutions of legal regulations may also strengthen and form the moral rules of market economy. While jurisdiction, in addition to its strictly meant “technical” tasks, may help the introduction of business honesty, may clarify the higher level of moral values and, during the course of the solution of legal conflicts, may turn into taking moral aspects into practise.

5. Broker scandals in 2015

The highest value economic crime came into light in 2015 in Hungary. The value of the suspected crime was 210.000.000.000 HUF, approximately 700.000.000 EUR, 1% of the GDP of Hungary.

Tens of thousands of Hungarian depositors and investors have been affected by the loss of hundreds of millions of EUR worth of assets. Local governments and various non-profits have lost hundreds of millions. Brokers have been arrested. At least one professional football club stands on the brink of bankruptcy. It turns out the Foreign Ministry kept billions of taxpayer money in high risk junk bonds. All of this has happened since police raided the Budapest headquarters of the Buda-Cash Broker House the night of February 23rd 2015.⁹

Hungary’s government denied insider trading after opposition members questioned a foreign ministry decision to withdraw state funds from a brokerage that filed for bankruptcy a few days later. The National Bank of Hungary suspended the licence of brokerage Quaestor on March 10, saying it may have sold more bonds than permitted under its issuance programme. The Hungarian opposition parties urged the foreign ministry to clarify whether it had any insider information about Quaestor’s finances. “The foreign ministry and its institutions had no unlawful information whatsoever,” it said on the government’s website. Quaestor was the third Hungarian brokerage to run into financial trouble within weeks in 2015.¹⁰

Quaestor scandal has many open questions in the end of the year 2016, and the possible length of this criminal procedure can be 5-10 years too. The most important question is: how effective are the rules and norms of the new Hungarian economic criminal law in the new Penal Code.

⁹ <http://budapestbeacon.com/public-policy/brokerage-scandal-engulphs-hungary/21158> (30. 08. 2016.)

¹⁰ <http://www.euronews.com/2015/03/27/hungary-orbans-government-denies-insider-trading> (30. 08. 2016.)